

## **Regulatory Summary**

### **Alternative Fuel Credit – IRS Notice 2006-92**

#### **Introduction**

On September 30, 2006, the Internal Revenue Service (IRS) issued guidance (IRS Notice 2006-92) concerning the tax provisions for alternative fuels and alternative fuel mixtures enacted in section 11113 of the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (“SAFETEA-LU”)<sup>1</sup>. SAFETEA-LU, among other things, includes the following changes: (1) it adjusts the excise taxes imposed on certain alternative fuels, including CNG and LNG; and, (2) it implements a new tax credit for certain alternative fuels and alternative fuel mixtures. These provisions are effective as of October 1, 2006. The adjusted excise rate is 0.183 “per energy equivalent of a gallon of gasoline” of CNG and \$0.243 per gallon of LNG.<sup>2</sup> The tax credit enacted in SAFETEA-LU is \$0.50 per gasoline gallon equivalent<sup>3</sup> of CNG and \$0.50 per gallon of LNG.

The IRS guidance in Notice 2006-92 mostly concerns the implementation of the fuel tax credits, including the incentive for straight alternative fuels as well as alternative fuel mixtures. It provides information on who receives the tax credit, how to take the credit, the units of measurement to be used for calculating the tax provisions, and the tax forms used. The tax credit can be taken as an excise tax credit, an income tax credit, or a direct payment, depending on the particular circumstances.

The summary below is not intended to be an exhaustive explanation of the tax provisions but instead an overview of the major provisions addressed in the IRS guidance. It does not address the application of the tax credit to motorboat use, or alternative fuel mixtures, since these issues are not of primary concern to NGVAmerica members. Please note that this summary was prepared for informational purposes only and is not intended to serve as legal advice. We suggest that you consult qualified legal counsel if specific questions arise concerning issues addressed in this summary.

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<sup>1</sup> Pub. L. No. 109-58, § 11113, 119 Stat. 1946 – 1949 (Aug. 8, 2005).

<sup>2</sup> The excise tax prior to October 1, 2006 was 48.54 cents per thousand cubic feet (MCF) in the case of CNG and \$0.119 per gallon of LNG.

<sup>3</sup> Section 11113(b)(2) defines a gasoline gallon equivalent as “the amount of fuel having a Btu content of 124,800 (higher heating value).”

## *I. Motor Vehicle Fuels*

The tax credit for alternative fuels extends to the sale or use of CNG and LNG when used as a “motor vehicle” fuel. The IRS regulations define “motor vehicle” in section 48.4041-8(c) to include on-road *as well as some off-road vehicles, such as forklifts*. The IRS regulations define a “motor vehicle” to include:

all types of vehicles propelled by motor that are designed for carrying or towing loads from one place to another, regardless of the type of load or material carried or towed and whether or not the vehicle is registered or required to be registered for highway use. Included are fork lift trucks used to carry loads at railroad stations, industrial plants, warehouses, etc. The term does not include farm tractors, trench diggers, power shovels, bulldozers, road graders or rollers, and similar equipment which does not carry or tow a load; nor does it include any vehicle which moves exclusively on rails.

The application of the tax credit is actually broader than the imposition of the excise tax. Under the guidance provided by the IRS, the sale (or use) of CNG and LNG for motor vehicles qualifies for the \$0.50 tax credit even if the motor vehicle is not registered for highway use, and even if no excise tax applies.

## *II. Tax Rates*

SAFETEA-LU adjusts the excise tax rate for CNG and LNG from 48.54 cents per MCF and \$0.119 per gallon, respectively, to \$0.243 per gallon of LNG and \$0.183 per gasoline gallon equivalent of CNG. SAFETEA-LU does not define gasoline gallon equivalent for purposes of the *excise tax*. The IRS guidance provides that a gasoline gallon equivalent of CNG is 126.67 cubic feet. There is no explanation as to how this figure was determined. It appears to be based on a calculation using a lower-heating value for CNG of approximately 900 Btu per cubic feet, and approximately 114,100 Btu for a gallon of gasoline.

The \$0.50 tax credit is per gallon of LNG and per gasoline gallon equivalent of CNG. For purposes of the tax credit, SAFETEA-LU defines a gasoline gallon equivalent as “the amount of fuel having a Btu content of 124,800 (higher heating value).” The IRS guidance indicates that in the case of CNG, the tax credit is to be calculated as \$0.50 per 121 cubic feet.

### III. *Determining Who Takes the Tax Credit – Seller or User*

According to the IRS guidance, the person generally responsible for reporting and paying the federal excise tax on CNG or LNG is the person that also takes the tax credit. In the typical case, the *seller* of the fuel takes the tax credit because they also are responsible for paying the excise tax. There are a number of situations, however, where the *user* of the fuel is the person responsible for the excise tax and, therefore, the person that takes the credit.

Specifically, the IRS' guidance indicates the "alternative fueler" is the person that takes the tax credit. The "alternative fueler," according to the guidance, is the person that is liable for reporting and paying the federal excise tax on the fuel, or would be liable for collecting the excise tax but for the fact that the use of the fuel is tax exempt (e.g., the sale and delivery of CNG to a state government fleet).<sup>4</sup> In order to determine who is responsible for collecting the federal excise tax, the guidance directs the reader to the IRS' regulations in sections 48.4081-3, 48.4081-5, and 48.4081-21.

The IRS regulations referenced above impose responsibility for collection of federal excise tax on the person selling the fuel but only if the sale involves the delivery of the fuel into a motor vehicle. This situation typically occurs at retail stations where fuel is purchased and placed in the fuel tank of a motor vehicle as part of a single transaction. It also may occur where a vendor provides full service for a private fleet (i.e., where the vendor arranges for purchase of fuel, maintains and operates the fueling station(s), and charges the ultimate user for all these services).

If the delivery of the fuel into a motor vehicle does not occur as part of a "sale", the operator of the motor vehicle is responsible for paying the excise tax. This situation can occur for CNG when natural gas is purchased by a fleet from the local gas utility and is later compressed using the fleet's own equipment or a private vendor's equipment.<sup>5</sup> In the case of LNG, the user of the fuel is the person liable for the tax *if* the fuel is purchased as part of a "bulk sale" and then later dispensed into the fleet's motor vehicles, and the customer has *not* provided to the fuel supplier a written

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<sup>4</sup> The IRS guidance on page 5 states that a claim for an alternative fuel payment may be made by the United States, a State, and certain tax-exempt organizations. This provision means that in some cases federal agencies and state government fleets using natural gas vehicles will be able to claim a payment for the \$0.50 tax credit.

<sup>5</sup> The IRS has indicated that ownership of the fueling equipment is not important to determining who is responsible for collecting the excise tax. The determinant factor is who owns the fuel immediately prior to it being dispensed into the motor vehicle. Therefore, if a fleet purchases fuel from entity A and contracts with entity B to own, operate and maintain fueling equipment on its property, the fleet would be the one responsible for collecting the excise tax and, therefore, would be considered the "alternative fueler" because it owned the fuel immediately prior to it being dispensed into its vehicles.

statement indicating that the fuel is intended solely for motor vehicle use.<sup>6</sup> The existing regulations (48.4041-5) allow the user of the fuel to pass the liability for the excise tax back to the bulk seller of motor fuel by providing the seller with a written statement indicating that the entire quantity of fuel is intended for use as a motor vehicle fuel and is taxable. It is unclear from the IRS's guidance whether these same procedures can be used to also pass back the \$0.50 tax credit.

#### *IV. 3 Ways to Claim the Credit – Excise Tax Credit, Income Tax Credit, or Payment*

As noted above, the IRS regulations indicate the tax credit goes to the “alternative fueler.” In addition to being the alternative fueler, the person or entity claiming the credit must have submitted an “Application for Registration,” (Form 637) and be registered with the IRS. The person or entity also must file a claim for the credit, or request a payment from the IRS. How the tax credit is taken depends on the particular circumstances and the tax liability of the taxpayer or entity claiming the credit.

If the person or entity claiming the tax credit has excise tax liability, the tax credit must first be claimed as an **excise tax credit** against such liability by filing a timely claim on Form 720, “Quarterly Federal Excise Tax Return.” If there is any excess credit remaining, and the person or entity claiming the credit is a taxable entity, the credit is taken at the end of the tax year as an **income tax credit** on Form 4136, “Credit for Federal Tax Paid on Fuels.”<sup>7</sup> If the tax credit is greater than the person or entities tax liability, a refund is issued. Corporate taxpayers that anticipate receiving an *income tax credit* as a result of the alternative fuel tax provisions have the option of reducing their quarterly estimated taxes by an appropriate amount.

Federal government, state government, and certain non-profit organizations that qualify for the tax credit may take the credit as a **claim for payment**, using Form 8849, “Claim for Refund of Excise Tax.” Such entities can take the credit as long as they are the seller of a qualifying alternative fuel, or they are the user of a qualifying alternative fuel, and no one else has taken the credit on the sale and delivery of alternative fuel into their motor vehicles. They also must be registered with the IRS as an alternative fueler; tax-exempt organizations also use Form 637 to apply for registration. The instructions to Form 8849 (Schedule 6) indicate that requests for claims must be for increments of at least \$750. In addition, if the tax-exempt organization owns and operates alternative fueling infrastructure and its sells

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<sup>6</sup> The IRS has indicated that the written statement can be an informal statement. The “bulk sale” provisions currently only apply with respect to taxable sale of motor fuels and the ability to pass back the obligation to pay the excise tax.

<sup>7</sup> This was a drafting error in SAFETEA-LU. It was intended that the excess credit could be recovered more frequently than once a year. Legislation to allow more frequent recovery of the excess credit has been introduced (“Tax Technical Corrections Act of 2006” (HR. 6264 and S. 4026)).

alternative fuel to private fleets, or persons subject to federal excise taxes, it is responsible for paying the federal excise taxes and must file Form 720, prior to requesting a claim for payment.<sup>8</sup>

## V. *Home Refueling*

The specific application of the excise tax and tax credit provisions for alternative fuels used by homeowners is not addressed in the Notice 2006-92. However, the IRS has addressed this issue in public statements and discussions with industry. If a homeowner refuels a natural gas vehicle using a home refueling unit, under existing IRS regulations, they are responsible for paying the excise tax. The excise tax credit can be taken by the homeowner against this obligation, resulting in no taxes owed. Whether the homeowner receives a payment or refundable credit for any excess tax credit (i.e., difference between \$0.183 and \$0.50 per GGE) depends on whether they use their home refueling unit for business purposes. A homeowner that uses their home refueling unit only for personal use may *not* request a payment or refundable credit. This is because the payment provision in section 6427(e) of the tax code, as amended by SAFETEA-LU, indicates that the payment for the alternative fuel credit may only be made if the sale or use of the alternative fuel is associated with a trade or business activity. Therefore, a homeowner that uses natural gas in a *personal* motor vehicle cannot receive a payment or a refund for the portion of the \$0.50 tax credit not used against excise tax liability. According to IRS officials, the homeowner nevertheless must be registered as an alternative fueller, and must file form 720, in order to take the excise tax credit.

## Step-By-Step Overview

### Taxable Entities

- Submit an Application for Registration as an alternative fueller, using Form 637, “Application for Registration”;
- Receive Acknowledgement from IRS that you are Registered;
- Quarterly, file Form 720, “Quarterly Federal Excise Tax Return, and claim the credit against any excise taxes owed;
- At the end of the tax year, file Form 4136, “Credit for Federal Tax Paid on Fuels,” if credit owed is greater than annual excise tax liability

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<sup>8</sup> Federal agencies qualify for the alternative fuel tax credit but are generally *not* exempt from paying federal excise tax on motor fuels. Thus, most federal agencies likely will have to file Form 720 and at least initially must take the tax credit as an excise tax credit.

Tax-exempt entities would follow these same procedures but would file Form 8849, "Claim for Refund of Excise Tax," instead of Form 4136.

### **Other Resources:**

Link to IRS Guidance - <http://www.irs.gov/pub/irs-drop/n-06-92.pdf>  
Publication 510, Excise Taxes - <http://www.irs.gov/pub/irs-pdf/p510.pdf>  
Form 637 - <http://www.irs.gov/pub/irs-pdf/f637.pdf>  
Form 720 - <http://www.irs.gov/pub/irs-pdf/f720.pdf>  
Instructions for Form 720 - <http://www.irs.gov/pub/irs-pdf/i720.pdf>  
Form 8849 - <http://www.irs.gov/pub/irs-pdf/f8849.pdf>  
Form 8849, Schedule 6 - <http://www.irs.gov/pub/irs-pdf/f8849s6.pdf>

At the time this summary was prepared, some of the required forms still needed to be updated to reflect recent tax changes.

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